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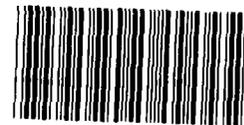
BY THE COMPTROLLER GENERAL
Report To The Chairman, Subcommittee On
Oversight And Investigations
Committee On Energy And Commerce
House Of Representatives
OF THE UNITED STATES

EPA Needs To Improve Its Oversight Of
Air Pollution Control Grant Expenditures

Section 105 of the Clean Air Act established a financial grant program to help state and local government agencies (grantees) prevent and control air pollution. In fiscal year 1983 grantees received about \$85 million from the Environmental Protection Agency (EPA) for this program.

GAO found that EPA was (1) consulting with appropriate state officials to determine, among other things, whether the grant program will be compatible with the objectives of other air quality projects in the states and (2) ensuring that each grantee uses the federal funds to supplement, not supplant, nonfederal (state and local) funds. However, two of the three EPA regions GAO reviewed had not implemented procedures to verify whether grantees maintained their levels of effort. When funding levels are not maintained, EPA cannot award subsequent grants to the grantee. GAO recommends that EPA develop and implement procedures to determine whether grantees maintain their nonfederal spending levels.

GAO also found that EPA did not have effective auditing controls to ensure that grantees' fund usage and reporting complied with EPA's requirements. To address this situation, GAO recommends that EPA's Inspector General reconsider the priority assigned to the section 105 program and, if appropriate, establish audit coverage sufficient to determine whether grantees' financial reports to EPA contain accurate and reliable information.



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GAO/RCED-84-163
SEPTEMBER 28, 1984

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-209872

The Honorable John D. Dingell
Chairman, Subcommittee on
Oversight and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

As requested in your February 8, 1983, letter and our subsequent discussions with your office, this report discusses the Environmental Protection Agency's (EPA's) air pollution control grant program authorized by section 105 of the Clean Air Act. EPA is required to ensure compliance with the act and related regulations in awarding grants to state and local air pollution control agencies. We examined how EPA and the state and local agencies were carrying out the requirements of the grant program.

As arranged with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days after the issue date. At that time we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,

A handwritten signature in black ink that reads "Charles A. Bowles".

Comptroller General
of the United States



COMPTROLLER GENERAL'S REPORT
TO THE CHAIRMAN, SUBCOMMITTEE
ON OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

EPA NEEDS TO IMPROVE ITS
OVERSIGHT OF AIR POLLUTION
CONTROL GRANT EXPENDITURES

D I G E S T

The Congress enacted the Clean Air Act in 1963 to protect and enhance the quality of the nation's air. Section 105 of the act, as amended, authorizes the Environmental Protection Agency (EPA) to award grants to state and local air pollution control agencies (grantees) to develop plans and implement programs to prevent and control air pollution or to address national air quality standards that EPA established to rid the air of excessive concentrations of harmful pollutants, such as carbon monoxide and lead. In fiscal year 1983 the Congress appropriated about \$85 million for the grant program, which EPA awarded to 139 grantees. (See p. 1.)

Prior to awarding section 105 grants, EPA is required to consult with appropriate state officials to determine, among other things, whether the grant program will be compatible with the objectives of other air quality projects in the states. Further, EPA has to ensure that grantees use the federal funds to supplement, not supplant, nonfederal (state and local) funds that would otherwise be made available to maintain their air pollution control programs. Grantees are required to maintain their nonfederal spending "level of effort" for recurring expenses, such as program administrative costs, each year in order to continue receiving grant funds, unless EPA determines that a reduction in expenditures is attributable to a nonselective reduction in expenditures in the programs of all executive branch agencies of the applicable unit of government. Nonrecurring expenditures, such as purchases of air monitoring equipment, are exempt from this requirement. Grantees must also comply with EPA's financial reporting requirements. (See pp. 1 and 2.)

(GAO/RCED-84-163)
SEPTEMBER 28, 1984

At the request of the Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, GAO reviewed EPA's procedures for ensuring grantee compliance with section 105 provisions and EPA regulations and determined whether grantees are, in fact, meeting these requirements. GAO reviewed all 235 grants awarded from fiscal years 1979 through 1982 at 3 of EPA's 10 regional offices to determine whether consultation, supplementing, and level-of-effort requirements were being met. Those grants represented about 35 percent of the \$340 million in grant funds awarded nationwide during that 4-year period. GAO also reviewed fiscal year 1982 expenditures (the latest data available at the time of GAO's review) for six grantees--two in each of the three regions--to determine whether the grant funds were properly spent and reported. GAO also visited three other grantees for further review after determining that EPA records did not contain a justification as to why those grantees' levels of effort had not been maintained. (See pp. 2 to 4.)

GAO found that the three EPA regions reviewed were consulting with state officials and were satisfied that supplanting did not occur, as required by the Clean Air Act. On the other hand, GAO found that two of the three EPA regions had not ensured that all grantees complied with the level-of-effort requirement of the act or EPA's reporting requirements. EPA officials believed the problems GAO found could exist in other regions not included in this review. (See chs. 2 and 3.)

EPA DOES NOT ENSURE THAT
GRANTEES COMPLY WITH SOME
GRANT REQUIREMENTS

GAO found that the three EPA regions' grant application approval processes included steps to ensure that an applicant did not receive a grant until EPA had consulted with designated state officials. In addition, each prospective grantee certified to EPA that its application had been submitted to the appropriate state officials for comment. Further, because EPA and the grantees negotiate the grantees' budgets and know the amounts of federal and nonfederal funds budgeted prior to grant

award, it is unlikely that the grantees could intentionally decrease funds at that time without EPA's detection. GAO's examination of grantees' budgets and reported expenditures did not reveal any evidence that supplanting occurred. (See pp. 6 to 8.)

GAO also found that one EPA region had monitoring procedures to ensure that all its grantees maintained the required funding levels. However, two of the three EPA regions GAO reviewed had no specific procedures to determine whether grantees' reported nonfederal expenditures were adequate to meet the level-of-effort requirement. In June 1982 the EPA Administrator had cautioned all regions not to allow grantees to fall below the required funding levels, but the Administrator provided no further guidance on developing procedures to ensure that the levels of effort were maintained. (See pp. 8 to 10.)

Without an effective means of monitoring whether grantees' nonfederal expenditure levels were maintained, the two EPA regions could not be sure that 12 grantees (out of 44 to 48 grantees annually) were qualified to continue to receive grant funds. However, after additional verification was performed by GAO and/or the EPA regions, 11 of the 12 grantees were found to have justified reductions. In the remaining case, a grantee could not justify reducing expenditures for fiscal year 1980 by \$13,492--yet it had continued to receive grant funds. The grantee had reported reduced expenditure levels to EPA, but they were undetected because the EPA regional office had not developed and implemented procedures to ensure that the level of effort was maintained. (See pp. 9 and 10.)

In addition to the level-of-effort problems cited above, GAO found 20 other instances within the 235 grant awards reviewed where unliquidated obligations (funds designated for specific purposes but not yet expended) were reported in "final" financial reports. This is contrary to the reporting instructions, which state that all obligations must be liquidated before final financial reports can be submitted. Those 20 reports were dated

from fiscal year 1979 through 1982 and reflected unliquidated obligations of \$986,716 which had not been resolved in one EPA region.

The region intends to resolve only the fiscal year 1982 instances, which amount to \$68,000, or 7 percent, of the total unliquidated obligations erroneously reported. EPA headquarters officials believe the region should resolve all the instances, if practical. GAO agrees, because EPA cannot assure compliance with the level-of-effort requirement unless it compares actual expenditures from year to year. Such comparisons need to exclude unliquidated obligations. (See pp. 13 and 14.)

EPA NEEDS AUDITS TO BETTER VERIFY GRANTEE'S EXPENDITURES

GAO found that four of the six grantees included in its review of fiscal year 1982 expenditures had submitted inaccurate or incomplete financial reports contrary to EPA's regulations. One grantee inappropriately charged expenditures of about \$8,200 to its fiscal year 1982 air pollution control grant. A second grantee underreported its nonfederal air program expenditures by \$241,670 which, according to a state program official, was done in order not to increase its required level of effort in subsequent years. A third grantee reported \$1.3 million in unliquidated obligations as expenditures. Excluding the unliquidated obligations, GAO found that the third grantee had received \$31,390 in grant funds to which it was not entitled. (See pp. 16 to 18.)

In the fourth case, GAO found that another state grantee reported a part (\$256,498) of two of its county agencies nonfederal expenditures because the state's expenditures for that year were insufficient to match its required level of effort. However, the state did not fully disclose the two county agencies' total nonfederal spending level of \$592,785. If the county agencies' spending cannot be used, then the state grantee did not meet its required funding level. On the other hand, if this practice is permissible, then the grantee did not fully disclose its nonfederal expenditures as required by EPA's

regulations. EPA's Office of General Counsel said that it would work with its regional offices to address the legal issues involved by not fully disclosing all expenditures to EPA. (See p. 18.)

Because the air pollution control grant program's funding size is small in relation to other EPA programs, EPA's Inspector General, who has the responsibility to audit and investigate all EPA programs and operations, has made it a low priority for audits. Between 1979 and 1982 the Inspector General's office audited 1 of the 235 air program grants GAO reviewed, although the EPA regions had requested that the Inspector General audit other air program grants. In one EPA region, for example, the program staff submitted 14 audit requests of air program grantees to the Inspector General between June 1981 and June 1982, which represented about one-third of that region's total air program grantees during that period. None of that region's 14 requests were subsequently audited.

Inspector General officials stated that they do not have enough resources to audit the grantees' financial reports, although a headquarters official believed that a sample of such audits could be a deterrent to misuse or inaccurate reporting of grant funds. Grant program officials stated that they lack the resources, as well as the expertise, to audit grantees' financial reports. For this reason, they rely on state auditors or public accounting firms to perform independent audits of federal grantees' financial operations. This type of audit is authorized by the Office of Management and Budget. Such audits are usually made on all federal funds awarded to a grantee rather than detailed grant-by-grant audits concerning the air pollution control program.

GAO believes the incidences of financial reporting errors shown in its review of the six grantees demonstrates the need for EPA's Inspector General to reconsider the priority now assigned to audits of the program. (See pp. 19 to 21.)

RECOMMENDATIONS

To ensure that all EPA regions determine whether grantees are complying with the level-of-effort requirement, GAO recommends that the EPA Administrator establish procedures for the regional administrators to follow in monitoring grantee expenditures. The procedures should emphasize that all obligations must be liquidated before financial reports can be accepted by EPA as final. The procedures should require the regions to examine grantees' past financial reports to ensure that levels of effort are maintained. (See p. 15.)

GAO recommends other actions that the EPA Administrator should take to resolve the specific concerns discussed in this report. (See pp. 15 and 22.)

Also, because (1) the Office of Inspector General is responsible for auditing and investigating all EPA programs and operations and (2) according to EPA officials, the regional program staff have neither the resources nor the expertise to verify grantees' expenditures, GAO recommends that EPA's Inspector General reconsider the priority assigned to the section 105 grant program, based on GAO's review findings, and if appropriate, conduct audits on specific grants to determine whether grantees' financial reports to EPA contain accurate and reliable information. (See p. 22.)

AGENCY COMMENTS

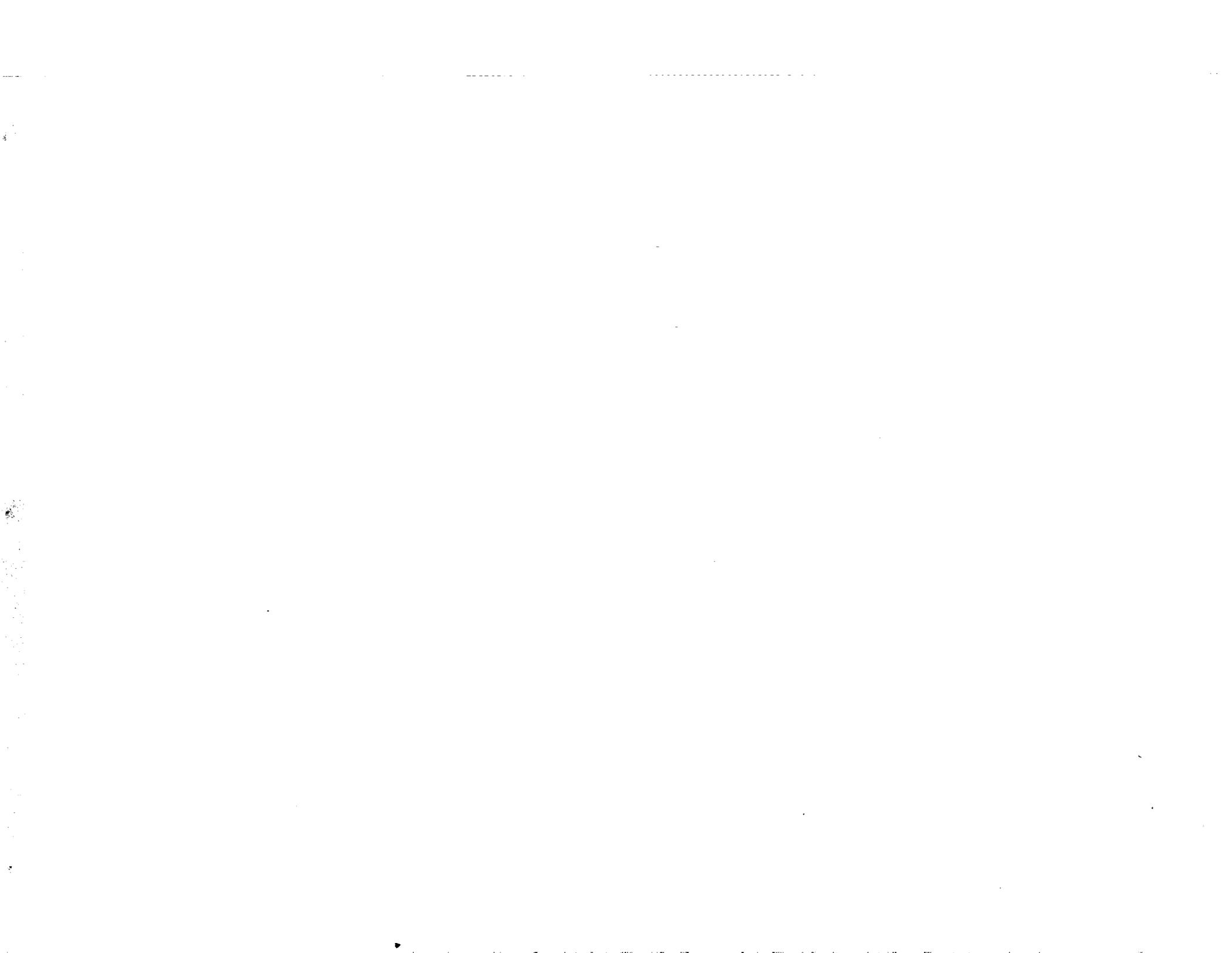
GAO did not obtain official agency comments on this report. However, GAO discussed its findings with EPA officials and with state and local officials responsible for the grants included in this review. Their comments have been included where appropriate in the report.

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ABBREVIATIONS

C.F.R.	Code of Federal Regulations
EPA	Environmental Protection Agency
GAO	General Accounting Office



CHAPTER 1

INTRODUCTION

The Congress enacted the Clean Air Act¹ in 1963 to protect and enhance the quality of the nation's air so as to promote public health and welfare. The act recognizes that state and local governments are primarily responsible for air pollution prevention and control, and it provides financial assistance to help carry out that responsibility. Section 105 of the act, as amended, authorizes the Environmental Protection Agency (EPA) to award grants to state and local air pollution control agencies (grantees) to develop plans and implement programs to control or prevent air pollution or to address national air quality standards that EPA has established to rid the air of excessive concentrations of harmful pollutants, such as carbon monoxide and lead.

Federal grant funds provided under the section 105 program amount to millions of dollars each year. In fiscal year 1983 the Congress appropriated the grant program about \$85 million, which EPA awarded to 139 grantees. The grant funds, together with state and local funds, are used primarily to pay for personnel and related administrative costs associated with planning and operating the various air pollution control programs. Personnel activities under these programs include issuing permits to new air pollution emission sources, inspecting the sources for permit compliance, and monitoring the air quality within designated areas to determine whether national standards are being met or maintained. Funds are also used to purchase equipment such as air monitors and vehicles needed to operate the air pollution control programs.

GRANT REQUIREMENTS

To be eligible for federal grant funds, grantees must meet certain Clean Air Act requirements. Section 105(b) of the act requires that grantees use federal grant funds to supplement, not supplant, nonfederal (state and local) funds that would otherwise be made available to maintain their air pollution control programs. Moreover, in order to receive grant funds in subsequent years, grantees are to maintain their prior years' nonfederal spending levels. That is, a grantee's expenditure of nonfederal funds (for recurrent expenses such as program administrative costs) during the current fiscal year cannot be less than such expenditures were during its preceding fiscal year, unless EPA determines that a reduction in expenditures is attributable to a nonselective reduction in expenditures in the programs of all executive branch agencies of the applicable unit of government. Nonrecurrent expenditures, such as purchase of air monitoring equipment, are exempt from this level-of-effort requirement.

¹42 U.S.C. § 7401 et seq.

While the supplementing and level-of-effort requirements both seek the same goal of maintaining nonfederal funding under the section 105 program, there is a difference. Determining that federal funds supplement, not supplant, nonfederal funds requires a judgment by EPA as to what nonfederal funds a grantee intended to provide for the program in the absence of federal funds. If a grantee reduces its nonfederal funds after federal funds are provided, and EPA can somehow show that those funds were intentionally reduced because of the availability of federal funds, then the grantee has supplanted nonfederal funds. Maintaining the nonfederal funding level, on the other hand, avoids a judgment by EPA as to what funds a grantee intended to provide for the air program. The requirement to spend nonfederal funds equal to the previous year's expenditure level leaves a grantee no choice but to maintain its funding level from year to year if it wishes to continue receiving section 105 grant funds.

Hypothetically, a grantee could maintain its level of effort and at the same time intentionally supplant nonfederal funds with federal funds. Take, for example, a situation in which a grantee has to maintain a nonfederal spending level of \$100,000 in order to receive a federal grant of \$50,000. The grantee decides to increase its nonfederal spending budget to \$150,000, while no corresponding increase in federal funds is planned. For some reason, the federal funds are later increased by \$25,000 (to \$75,000), and consequently, the grantee intentionally reduces its budgeted nonfederal funds by \$25,000 (to \$125,000). In this case, the grantee still exceeds its required level of effort (\$100,000), yet it has supplanted nonfederal funds by \$25,000 because it intentionally reduced those funds after learning that federal funds were to be increased.

Grantees must also comply with EPA's financial reporting requirements. Specifically, grantees must maintain an accurate, current, and complete accounting of all financial transactions. Also, EPA requires that grantees submit final financial reports only after all obligations have been liquidated (expended).

EPA, in awarding grants, must fulfill certain responsibilities. For example, EPA may not award a grant until it (1) has consulted with appropriate state officials to determine, among other things, whether the air pollution control grant program will be compatible with the objectives of other air quality projects in the state, (2) is satisfied that supplanting of nonfederal funds will not occur, and (3) has determined that the grantee will maintain its nonfederal level of effort. EPA carries out its responsibilities under the act through its 10 regional offices.

OBJECTIVES, SCOPE, AND METHODOLOGY

At the request of the Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce, we reviewed certain matters regarding the air grant program

authorized under section 105 of the Clean Air Act.² Specifically, the Chairman asked us to examine how EPA (1) carries out the consultation requirements with state officials, (2) determines whether federal funds supplement, not supplant, state/local funds, and (3) determines whether grantees are maintaining their levels of effort. The Chairman also asked us to examine EPA's enforcement of the act's provisions. During our review, we met and reached agreement with the Subcommittee's office to visit three EPA regional offices and six state grantees to determine how well they were complying with the grant program requirements and the relevant EPA regulations during the past several years.

Our review was performed from July through December 1983 and included 3 regions from EPA's 10 regional offices--Region III (Philadelphia, Pennsylvania); Region IV (Atlanta, Georgia); and Region VI (Dallas, Texas). As agreed with the Subcommittee office, we selected these regions because together they provided both a broad geographic coverage and the largest number of grantees and grant funds awarded. Our review work in these three regions included all 235 of the section 105 grants awarded from fiscal year 1979 through 1982 (the latest fiscal year for which data were available during our review). Annually, the number of grants varied from 60 in fiscal year 1979 to 56 in fiscal year 1982 and represented about 35 percent of the \$340 million in grant funds awarded nationwide during that 4-year period. Our review was not based on a statistical sample of all the state and local agencies receiving grants in the program; consequently, the results cannot be projected to the entire section 105 program.

To ascertain what administrative actions EPA takes to ensure compliance with section 105's requirements, we interviewed financial management and grant program officials in Regions III, IV, and VI. We reviewed the processes and procedures which the three EPA regions followed in awarding air pollution control grants to state and local grantees. We then examined all of the 235 grant award records at the regions from fiscal year 1979 through 1982 to obtain the following:

- The specifics of the grant application and budget estimates, as well as the approved EPA grant assistance agreements, in order to determine how EPA carries out the consulting and supplementing requirements of the Clean Air Act.
- The actual nonfederal expenditures, as reported on the final financial status reports that the grantees are required to submit annually to EPA, in order to compare each grantee's reported expenditures from one fiscal year to another to ascertain whether the required levels of effort were maintained.

²This report addresses one of two issues that the Chairman requested us to pursue. The other issue, which pertains to state-delegated air pollution control programs, will be addressed in a subsequent report.

We also reviewed the final financial status reports in each of the three regions to determine whether they were in compliance with EPA's reporting requirements. Then, in each region, we selected two state grantees to visit to verify their actual fiscal year 1982 air pollution control program expenditures (which was the latest complete expenditure information available during our review). The six grantees visited were Maryland and the District of Columbia (Region III), North Carolina and Florida (Region IV), and Texas and Louisiana (Region VI). As agreed by the Subcommittee's office, grantees were selected from those with reductions in expenditures as well as those that had maintained their spending levels. In addition to those six grantees, we selected three other grantees to visit for further review after finding that EPA records did not indicate why their levels of effort were not maintained. Those three grantees visited were Kentucky; Knox County, Tennessee; and San Antonio, Texas.

To determine how well grantees had complied with the requirements of section 105, we interviewed state and local program officials who were responsible for the nine grantees mentioned above. From those interviews and a verification of actual expenditure documents, we compared the actual nonfederal and federal expenditures with the expenditures that the grantees had reported on their final financial status reports to EPA.

To address the Chairman's concern about EPA's enforcement of the act's provisions, we met with staff from EPA's Office of General Counsel to obtain their views on the problems identified in our review.

At the Subcommittee Chairman's request, we did not obtain agency comments on this report. We did, however, discuss in January and February 1984 the report's contents with EPA headquarters officials and regional administrators or their designees in the three EPA regions we visited. We also discussed our review findings, as applicable, with state and local officials of the nine grantees as they were reviewed. Their comments have been included where appropriate in this report. Except as noted above, our review was performed in accordance with generally accepted government auditing standards.

CHAPTER 2

EPA NEEDS BETTER PROCEDURES FOR IMPLEMENTING THE AIR GRANT PROGRAM

Section 105 of the Clean Air Act directs that EPA perform certain duties in connection with its administration of the air grant program. Before awarding grants, EPA has to consult with appropriate state officials; be satisfied that grant funds will be used to supplement, rather than supplant, state or local expenditures for clean air programs; and determine that grantees will maintain their required levels of effort from year to year. If grantees do not maintain the required funding levels, the act requires EPA to discontinue awarding further grants to them. In addition, EPA reporting requirements provide that grantees must liquidate all obligations before submitting final financial reports to EPA each year. That requirement directly affects the level-of-effort requirement, wherein actual nonfederal expenditures must be compared from year to year.

We found that the three EPA regions reviewed had carried out their consulting responsibility as required by section 105. In addition, we found no evidence that grantees were supplanting non-federal funds with federal grant funds. We observed, however, that neither EPA headquarters nor two of the three EPA regions had procedures to ensure that grantees were maintaining the required funding levels of effort. In the absence of such procedures, we found 12 instances within the 235 grant awards reviewed where grantees' financial status reports indicated that the levels of effort had not been maintained. Those instances required additional followup at the region or with the grantees before we could determine whether the grantees had or had not actually maintained their levels of effort. We also found that the region which had procedures, after discovering that a grantee had not maintained its level of effort, required the grantee to pay EPA the amount needed to meet the required level. EPA concluded that such payment brought the grantee into compliance and avoided the need to discontinue the grant, as otherwise required by the act.

We found that EPA had accepted some grantees' final financial status reports that were not in compliance with EPA requirements. As a result, 20 of the 235 grants awarded during the fiscal year 1979-82 period reflected unliquidated obligations¹ that were being treated by EPA as actual expenditures. All of the 20 instances occurred in a region that had not monitored its final financial status reports for such problems.

EPA officials in the regions included in our review said that the problems we found could similarly be affecting the seven regions that we did not review.

¹Unliquidated obligations refer to those funds that have been designated for specific purposes, but not yet expended.

EPA REGIONS ARE MEETING THE
CONSULTING REQUIREMENT

According to section 105, EPA may not make any grant "until the Administrator has consulted with the appropriate official as designated by the Governor or Governors of the State or States affected." Among other things, such consultation is done to ensure that the grant program will be compatible with the objectives of other air quality projects in the state. The consultation responsibility has been delegated by the EPA Administrator to the regional administrators, as provided by the EPA Delegations Manual and EPA regulations.²

A preliminary consultation on grant objectives, conditions, and amounts is conducted between the grantee's project manager and an EPA regional officer assigned to the project before the grantee's application is transmitted to EPA for approval. Once that step is completed, EPA has instituted grant application procedures to ensure that consultation between the regional administrator and the designated state representative is performed for each grant. EPA's grant application form contains a section where grantees certify that their applications have been submitted to the appropriate "clearinghouses" (officials designated by the Governor of the state affected) to ensure that duplication of air pollution control activities is avoided. All written comments from those officials are to be attached to the application for EPA review. In Regions III, IV, and VI, the project officers, in processing grant applications, check to see that all grant applicants have followed the required clearinghouse procedures.

Region IV has also developed an internal checklist, known as the Grant Application Processing Summary Report, which it uses in addition to the above procedures to document that all consultation requirements are met. The checklist includes an item for notifying appropriate officials. For instance, the checklist for the Broward County Environmental Quality Control Board of Fort Lauderdale, Florida, indicated that the application had been sent to the following authorities:

- the Florida Bureau of Intergovernmental Regulations,
- the Broward County Planning Council, and
- the South Florida Regional Planning Council.

After the consultation is complete, the grant agreements between EPA and the grantees are generally transmitted from the regional administrators to the heads of the grantees' air pollution control programs for final acceptance and approval.

²EPA Directive 1100, Organization and Functions Manual, also indicates that all functions of the air grant program are to be performed by EPA's regional administrators.

In our review of the 235 grants awarded for fiscal years 1979 through 1982 in Regions III, IV, and VI, we found that the consultation procedures were followed, and we believe the procedures are adequate; thus, the three EPA regions we reviewed are meeting the act's consultation requirement.

GRANT FILES DO NOT
INDICATE SUPPLANTING

Under section 105(b), EPA may not award funds to any agency for its clean air program unless the Administrator is satisfied that the grant

" . . . will be so used to supplement . . . the level of . . . non-Federal funds that would in the absence of such grant be made available for the maintenance of such program, and will in no event supplant such . . . non-Federal funds."

EPA regulations³ require grant applicants to provide the regional administrator assurance that the requested air program funds will not supplant nonfederal funds that the applicant would otherwise have available for maintaining the section 105 program. The regulations do not stipulate what constitutes assurance. The 235 grant files we reviewed contained no documented assurance from grantees that supplanting would not occur.

EPA's Associate Administrator for Policy and Resource Management has stated⁴ that none of the section 105 grants supplant funds from other sources. Further, EPA regional officials said that supplanting does not exist because they negotiate the grantees' budgets and know the amount of federal and nonfederal funds budgeted before awarding the grants. Thus, any intentional decrease in nonfederal funding caused by a similar increase in federal grant funds (which is supplanting) could be identified. Our examination of grantees' budgets and expenditures, as reported to EPA Regions III, IV, and VI, from fiscal years 1979 through 1982, did not reveal any evidence that increases in federal grant funds were being offset by similar decreases in nonfederal funds.

The determination that grant funds will supplement, not supplant, nonfederal funds is very subjective and difficult for EPA to make. As we stated in a previous report,⁵ to determine whether grant funds supplant nonfederal funds, an agency must first know what funds the grantee would have budgeted had federal

³40 C.F.R. 35.520(d) (1982), as amended, 40 C.F.R. 35.210(b) (1983).

⁴An April 1, 1983, letter to the Chairman, Subcommittee on Oversight and Investigations, House Committee on Energy and Commerce.

⁵Proposed Changes in Federal Matching and Maintenance of Effort Requirements for State and Local Governments (GGD-81-7, Dec. 23, 1980).

funds not been available. Then, an agency must assess the motives behind any subsequent decreases in a grantee's budget and be able to tie them directly to similar increases in federal funds. Because the grantee's budget and the federal and nonfederal fund amounts are negotiated between EPA and the grantee prior to grant award, it is unlikely that the grantee could intentionally decrease its funds at that time without EPA's detection. Further, even if the grantees' funds were decreased, EPA would have to show that those decreases were directly linked to increases in federal grant funds.

EPA NEEDS TO ENSURE THAT GRANTEE'S LEVELS OF EFFORT ARE MAINTAINED

For a grantee to remain eligible to receive federal grant funds, the grantee has to spend on its current year's section 105 program at least as much nonfederal money for recurrent expenses as it spent in the prior fiscal year. For example, if a grantee's recurrent expenditures for fiscal year 1980 were \$100,000, then its recurrent expenditures for fiscal year 1981 would have to remain at or exceed that amount. In determining the level of effort, unliquidated obligations cannot be considered a part of the recurrent expenditures. (The GAO report referred to in footnote 5 proposed alternatives to this level-of-effort requirement.)

EPA has recognized that it has a responsibility to assure that grantees satisfy their level-of-effort requirements. In a January 15, 1982, letter sent to the Region VII administrator after an EPA audit showed that a grantee in that region had not met the required funding level, EPA's Assistant Administrator for Administration stated that section 105(b) and EPA regulations require a grantee's "actual non-federal expenditures during a given fiscal year to equal or exceed the non-federal expenditures of the prior fiscal year." The Assistant Administrator indicated that EPA should routinely review grantees' final financial status reports to assure that nonfederal expenditures are adequate.

In a June 16, 1982, memorandum, the EPA Administrator provided all regional administrators with copies of the Assistant Administrator's letter and cautioned them not to allow grantees to fall below the required funding level. The Administrator, however, provided no further guidance to the regional offices on developing procedures to assure that nonfederal expenditures are adequate to satisfy the level-of-effort requirement. As a result of not requiring such procedures, two of the three regions in our review had taken no action to develop and implement them.

Two of the three EPA regions reviewed need procedures for monitoring the level of effort

Although the EPA Administrator cautioned the regional administrators not to allow grantees to fall below their required funding levels, only one of the three EPA regions we reviewed

performed routine monitoring to determine whether grantees' non-federal expenditures were adequate to satisfy the level-of-effort requirement. Without specific guidance from EPA headquarters, the other two EPA regions had taken little or no action to make such determinations. Therefore, those two regions could not be certain that they were meeting their statutory obligation to ensure that grantees maintain the required funding levels.

Region VI officials told us that they had implemented a system to review grantees' expenditure levels as follows: when a grantee's final financial status report is received, Region VI's project officers (from the Grants Administration Branch and the Air Branch, Air and Waste Management Division) jointly review it to determine whether the grantee has met the required level of effort. The project officers also review grant applications, comparing the grantee's budgeted outlays with the preceding year's actual expenditures, to ensure that the grantee plans to meet the required spending level. If the grantee's budget does not meet its earlier expenditure level, the region contacts the grantee for an explanation of the planned shortfall. If a reduction in spending is actually planned, the project officers also require the grantee to notify EPA by certified letter that the required level of effort will be met in the current year.

In contrast to Region VI, EPA Regions III and IV had no systematic procedures for determining whether required levels of effort were maintained. Although Region III's controller told us his staff checks to see that grantees are maintaining their levels of effort, there was no systematic documentation to ensure that such checks were performed. In our review of Region III grant awards for the fiscal year 1979-82 period (which ranged from 19 to 23 grants each year), we found level-of-effort verifications noted in six grant files. In Region IV there was no agreement among officials concerning whether procedures for monitoring the level of effort were needed or who should be responsible for developing and implementing them.

Without procedures to determine whether grantees are maintaining the required levels of effort, EPA has not ensured that its grantees are maintaining the funding levels needed to be eligible to receive section 105 grant funds. Our review of the 235 grants awarded at the three EPA regions showed 12 instances in two regions where grantees' final financial status reports indicated that the required levels of effort had not been maintained.

In Region III, we found that two grantees' final financial status reports (out of 19 to 23 grantees annually) indicated that the grantees had not maintained their required levels of effort. There was no documentation in the grant files showing whether the regional staff had previously checked the reported funding levels, and regional officials told us they were unaware of any shortfalls. After further discussing the two cases with EPA regional officials, they contacted the grantees, who submitted revised financial status reports showing that the required levels of

effort were maintained. One grantee had reported duplicate expenditures for the previous year which had to be adjusted, and the other grantee had nonrecurrent expenditures which made up for the level-of-effort shortfall.

We found 10 cases in Region IV (out of 25 grantees annually) where grantees' final financial status reports indicated reductions in levels of effort. As in the previous region, the reported funding levels had not been checked against the prior year's level, and EPA was unaware of these reported reductions. In 4 of the 10 cases, we performed detailed reviews of the grant files in the regional office and obtained documentation showing that the grantees had enough nonrecurrent expenditures in their previous years' reports to maintain their required funding levels. In three other cases, EPA contacted the grantees and documented that the reported reductions resulted from nonrecurrent expenditures included in the previous years' reports. In the three remaining cases, we visited the grantees and reviewed their financial reports. In two of those cases, we found that the reductions were offset by nonrecurrent expenditures. In the other case, the grantee was unable to maintain its required funding level even after allowable adjustments were made to the final financial status report. That grantee--Knox County, Tennessee--did not have the necessary recurrent expenditures in fiscal year 1980 to meet its required level of effort by more than \$13,000, yet it had continued to receive subsequent grants from Region IV.

According to files at the Knox County Department of Air Pollution Control, the grantee's nonfederal expenditure level for fiscal year 1980 was \$94,027, which was below the fiscal year 1979 funding level of \$97,670.⁶ The 1980 amount decreased to \$84,178 when we adjusted for \$9,849 in nonrecurrent expenditures. Consequently, Knox County did not meet its level-of-effort requirement for fiscal year 1980 by \$13,492. This shortfall was undetected by EPA because it had no monitoring procedures, and Knox County received grants for succeeding fiscal years. EPA and the grantee both agreed after our review that the required level of effort was not maintained, and they are now discussing various means of dealing with the shortfall.

In Region VI, our review of fiscal year 1979-82 grants (12 grants annually) showed no instances of undetected reductions in grantees' levels of effort. We believe this was because Region VI had implemented procedures to check grantees' final financial status reports from year to year.

⁶This figure was arrived at by adjusting for errors we found in the grantee's financial records. The final Knox County financial status report for fiscal year 1979 reported total nonfederal expenditures as \$104,074, but our review showed this amount to be overreported by \$1,166. We also established that the grantee had nonrecurrent expenditures of \$5,238 during that year. Adjusted for these findings, Knox County's actual recurrent expenditures for fiscal year 1979 totaled \$97,670.

With or without procedures, some grantees notified EPA when they did not maintain their levels of effort

The three EPA regions we reviewed had documented nine instances (out of 235 grants) where grantees had not maintained their required levels of effort. In those nine cases, the grantees had alerted EPA to the shortfalls and the cognizant EPA region dealt with them in one of four ways:

- In three cases, the EPA regions discontinued the grants after the grantees' programs did not meet the required levels of effort, and the programs stopped operations.
- In four cases, the EPA region discontinued the grant and subsequently awarded funds to the state as grantee, to be passed through to the local agency.⁷
- In one case, the EPA region permitted the grantee to pay EPA the amount of the shortfall and continued the grantee's eligibility for subsequent grants.
- In one case, the EPA region determined that the grantee's shortfall was justified by a nonrecurrent expenditure and continued the grantee's funding.

In Region IV, for example, the local air pollution control program run by Mobile County, Alabama, could not maintain its level of effort for fiscal year 1980. Consequently, EPA did not award it subsequent grants, and the Mobile County air program stopped operations on July 1, 1980. Similarly, in Region III, grants to two grantees--Richmond, Virginia, and the Pennsylvania Department of Transportation--were discontinued (in fiscal years 1981 and 1982, respectively) when the grantees could no longer maintain their levels of effort. Richmond's nonfederal expenditure level was 25 percent less than it was the prior year; Pennsylvania's level was 44 percent less. Consequently, those two air programs also stopped operations. (In fiscal year 1984, however, the former Pennsylvania grantee began a new program with larger state funding, and it was provided a new grant award by EPA.) In these three cases, the respective state grantee assumed any air pollution control activities which it believed were essential to provide overall state coverage.

Grants to four other local grantees⁸ in Region III were also discontinued after the grantees found that they could not maintain

⁷Under this procedure, the state and local air pollution control agencies developed an arrangement whereby the local agency would receive federal funds for its air program from the state. The EPA grant to the state specifically designated what federal funds the local agencies were to receive.

⁸Baltimore City, Baltimore County, and Frederick County, Maryland; and Wheeling, West Virginia.

their required funding levels. However, EPA subsequently awarded funds to the states as grantees to be passed through to the local agencies. The local agencies were no longer considered EPA grantees, and they were not required to maintain any level of effort to receive pass-through funding.

Region VI permitted a grantee to pay EPA the amount needed to increase its nonfederal funds to the required level, once the level-of-effort shortfall was disclosed. That action was an effort by EPA to prevent discontinuing subsequent grants to the grantee. Arkansas had not maintained its level of effort during fiscal year 1981, but that fact did not become known to EPA until the state filed its final financial status report for fiscal year 1981--which it did in February 1983. By that time, Arkansas had already received two more grants for fiscal years 1982 and 1983. Rather than annul the latest grants and cause the program to cease operations, Region VI proposed that the state pay EPA the amount needed to maintain the required level of effort--a sum (\$5,632) which both parties agreed was the amount of the shortfall. By that payment, EPA permitted Arkansas to continue its grant eligibility. EPA's Office of General Counsel told us that this action is a legal way to maintain a grantee's level of effort without having to discontinue subsequent grant funds, as would otherwise be required by the act.

Region VI also waived the level-of-effort requirement for another grantee--the Metropolitan Health District of San Antonio, Texas--which it decided was permissible. For its fiscal year 1981 grant, the San Antonio district budgeted nonfederal expenditures of \$101,815. However, during that fiscal year San Antonio city employees received pay raises. Since the grantee had not budgeted for those raises, the city transferred sufficient funds to the district to pay the extra personnel costs. That action boosted the San Antonio district's nonfederal expenditures (as reported on its final financial status report for fiscal year 1981) to \$116,815--\$15,000 over its budget.

Under section 105, the additional \$15,000 expenditure in fiscal year 1981 should have raised the grantee's required level of effort in subsequent grant years to \$116,815. However, Region VI considered the \$15,000 pay raise as a nonrecurrent expenditure, not subject to the level-of-effort requirement.

EPA defined nonrecurrent expenditures to include (a) certain equipment purchases, (b) Clean Air Act projects supported by other than section 105 grants, and (c):

"Those expenditures which are identified as being acceptable as nonrecurrent expenditures under generally accepted accounting principles. Such nonrecurrent expenditures must have the prior approval of the Regional Administrator." (40 C.F.R. 35.501-8 (1982))

The San Antonio district did not identify the expenditure as nonrecurrent under generally accepted accounting principles nor was it approved as nonrecurrent by EPA's regional administrator. Therefore, in our opinion, the pay raises to the San Antonio city employees should have been considered recurrent expenditures. Accordingly, the grantee's required level of effort for fiscal year 1982 should have been \$116,815.

In fiscal year 1982 San Antonio's actual nonfederal expenditures amounted to \$97,863, which was below the 1981 nonfederal spending level with or without the added pay raise expenses. In our opinion, the grantee missed its level of effort for 1982 by \$18,952--the difference between the 1981 nonfederal expenditures level of \$116,815 and the 1982 level of \$97,863. EPA Region VI officials told us they agree that San Antonio missed its level of effort by \$18,952, and they are now discussing with the grantee various means for dealing with the shortfall.

EPA needs to ensure that final financial reports do not include unliquidated obligations

EPA regulations required grantees to submit a financial status report within 90 days after each budget period and within 90 days after project completion or termination (40 C.F.R. 30.635-3 and 35.415 (1982)).⁹

The financial status report form instructs grantees to report total federal and nonfederal expenditures and to submit "final" financial status reports that do not contain any unliquidated obligations. Therefore, if any financial status report filed within the required 90 days includes unliquidated obligations, the grantee must submit a final financial status report after liquidating those obligations.

During our review of the 235 grant awards, we found 20 instances where grantees in Region IV had reported unliquidated obligations in financial status reports identified as "final," and then neither the grantee nor EPA took action to have the unliquidated obligation balances resolved. The reporting instructions require grantees to file final financial status reports immediately after all obligations are liquidated, and in no instance should unliquidated obligations be reported in final reports. Yet, as of September 1983, Region IV had received 20 financial status reports

⁹For grants awarded after September 1983, EPA amended its regulations to clarify that a financial status report is required within 90 days after the end of each budget period and a final report is required immediately after all obligations are liquidated. This clarification responded to concerns that the financial status report is seldom final within 90 days because it often includes unliquidated obligations. (48 Fed. Reg. 45059 (Sept. 30, 1983))

identified as final which contained unliquidated obligations totalling \$986,716. Of those financial status reports, seven dated from fiscal year 1979, five from fiscal year 1980, five from fiscal year 1981, and three from fiscal year 1982.

Officials at Region IV's Grants Administration Section told us that they intend to resolve only the three cases of unliquidated obligations reported for fiscal year 1982. That action would resolve about \$68,000 (7 percent) of the \$986,716 reported as unliquidated obligations since 1979. Region IV officials said that it would be too time consuming to resolve the earlier cases. We discussed this matter with EPA headquarters officials, and although no action was indicated by them, they believed an attempt should be made by Region IV to resolve all of the cases, if practical.

It is in the government's interest for EPA to ensure that final financial status reports are submitted after all obligations have been liquidated. If final financial status reports are not promptly and properly filed as required, then EPA cannot determine the correct amount of the grantees' actual expenditures. This directly affects EPA's ability to assure compliance with section 105's level-of-effort requirement, wherein actual nonfederal expenditures must be compared from year to year.

CONCLUSIONS

The three EPA regions we reviewed had implemented procedures to carry out consultation with grantees as required by the Clean Air Act. Moreover, considering the subjective nature of determining whether a grantee supplants nonfederal funds with federal funds, we found no evidence from our grant file review of the three regions to indicate that EPA awarded grants that supplanted nonfederal funds.

The Clean Air Act requires that grantees maintain their non-federal spending level from year to year to be eligible to continue receiving section 105 grant funds. We found, however, that two of the three EPA regions reviewed had not implemented procedures which would have enabled them to detect potential or actual level-of-effort reductions in grantees' nonfederal expenditures. Without procedures to monitor the level of effort, the two regions did not know that 12 grantees had reported shortfalls in their nonfederal expenditures, so the regions had taken no action to resolve those problems. As a result, the regions could not determine whether the grantees were eligible for subsequent grants until additional work was performed by the regions or by us to verify the grantees' expenditures. After completing the additional work, we found that 11 of the 12 grantees were able to justify their reported shortfalls with allowable reductions. One grantee in Knox County, Tennessee, had not maintained its required level of effort by \$13,492. That grantee had continued to receive subsequent grants from the EPA region, in violation of the Clean Air Act's level-of-effort requirement.

In another case, EPA decided that a grantee in San Antonio, Texas, was eligible to continue receiving grant funds even though the grantee had missed its level of effort by \$18,952. We disagreed with EPA's justification of the shortfall as a nonrecurrent expenditure. After our review, the EPA regional officials agreed with us that the grantee's reduction was not justified and that EPA should take action to deal with the shortfall.

In our review of the 235 grants awarded by the three EPA regions from fiscal year 1979 through 1982, we found 20 instances in Region IV where grantees had reported unliquidated obligations in their final financial status reports to EPA. According to instructions on the financial status report form, final reports should not contain any unliquidated obligations. Therefore, those 20 instances, and any similar reports in other EPA regions, need to be resolved so that EPA can determine if actual expenditures are sufficient for grantees to maintain their required levels of effort and be eligible to continue receiving grant funds.

EPA needs to establish in all its regions an effective monitoring procedure to ensure that grantees are conforming with the level-of-effort requirement of the Clean Air Act and take appropriate action to discontinue subsequent grant funds when grantees do not maintain their required expenditure levels. Further, because we found that two of the three regions reviewed did not have such procedures, and EPA officials believe the problems we found could exist in the other regions not included in our review, those latter regions should, if necessary, examine their grantees' past financial status reports to ensure that levels of effort were maintained.

RECOMMENDATIONS

To ensure that all EPA regions determine whether grantees are complying with the level-of-effort requirement of the section 105 grant program, we recommend that the EPA Administrator establish procedures for regional administrators to follow in monitoring grantee expenditures. The procedures should emphasize that all obligations must be liquidated before financial reports can be accepted by EPA as final. Also, the procedures should require the regions to examine grantees' past financial reports to ensure that levels of effort are maintained.

We also recommend that the EPA Administrator ensure that the regional administrators in Regions IV and VI take appropriate action with respect to the grantees in Knox County and San Antonio, respectively, concerning their reductions in levels of effort.

CHAPTER 3

EPA NEEDS TO VERIFY THAT GRANTEES'

EXPENDITURES COMPLY WITH REGULATIONS

The Clean Air Act requires that grantees receiving section 105 grant funds comply with EPA's grant regulations. Those regulations include requirements that grantees accurately and completely account for all federal and nonfederal air pollution control program expenditures.

Our review of the expenditure records of 6 of the 56 fiscal year 1982 grantees in EPA Regions III, IV, and VI showed that one grantee used federal funds for purposes other than for its air pollution control program. Our review also showed that four of the six grantees had not submitted accurate or complete financial status reports, although the certification statement signed by each grantee assured such reporting. EPA was unaware that these situations had occurred because it did not have adequate auditing coverage of grantee expenditures to detect the problems.

Regional officials said that they do not have sufficient resources available to determine compliance with all grant requirements. Because EPA does not have effective financial controls over use of federal grant funds, it cannot determine whether grantees misdirect or misreport such funds.

GRANTEES' FUND USAGE AND REPORTING DO NOT ALWAYS COMPLY WITH EPA'S REGULATIONS

Under section 105, grantees may use grant funds only for air pollution control. Also, EPA regulations¹ contain general requirements for federal grantees concerning their financial management systems and reports. Specifically, the regulations require grantees to maintain a system that includes

- control over and accountability for all project funds, property, and other assets, as well as assurance that these were used solely for their authorized purposes (i.e., air pollution control) and
- an accurate, current, and complete accounting of all financial transactions.

One grantee made unauthorized expenditures with air pollution control grant funds

In Region III we found expenditures charged to the District of Columbia's Department of Environmental Services' fiscal year 1982 air pollution control program which should have been charged

¹40 C.F.R. 30.800 (1982), as amended, 40 C.F.R. 30.510 (1983).

to its water pollution control program. According to the District's Chief, Program Development and Support Services, the air pollution control grant was charged approximately \$6,650 in personnel costs and \$286 for a typing course for one clerk-typist who worked exclusively on the District's water program. In total, the District charged about \$6,936 of its \$667,032 fiscal year 1982 air pollution control grant which was unauthorized because the expenditures were not used solely for their authorized purposes, as required by EPA regulations. EPA Region III and the District are currently pursuing this issue to determine the exact amount of the unauthorized costs.

Four grantees filed inaccurate
or incomplete financial reports

We found that 4 of the 6 grantees included in our review of fiscal year 1982 expenditures had incorrectly and/or incompletely reported their air pollution control program expenditures to EPA. Two of the four grantees overreported expenditures, while the remaining two underreported expenditures. All four grantees, however, continued to meet or exceed their previous years' funding levels. EPA regional officials were unaware of these financial reporting problems until we brought them to their attention. Unless these problems are resolved, EPA cannot determine the actual expenditure levels of those grantees. Without such knowledge, EPA is continuing to award subsequent grants to those grantees based on incorrect or incomplete financial reports.

In Region III we determined that the District of Columbia had made bookkeeping errors in its report of fiscal year 1982 expenditures. Erroneous charges during that fiscal year's grant included expenditures for laboratory services (\$167) and supplies (\$144) which should have been charged against fiscal years 1981 and 1983, respectively. Also, a duplicate payment (\$207.90) had been returned to the District by a vendor, but the District had not deducted that amount from its 1982 expenses. Adding these sums to the \$6,936 improperly charged to the air pollution control program, as previously described, and allowing for 10 percent in indirect costs as set forth in its grant agreement, we determined that approximately \$8,200 of the District's \$667,032 fiscal year 1982 grant should not have been charged to that grant. We informed the grantee at the completion of our review and the regional administrator in February 1984 of this situation and were later told by a regional official that he was working with the grantee to resolve the inaccurate charges.

In Region VI we found that one grantee had underreported its air grant expenditures for fiscal year 1982. During our review of grant records at the Louisiana Department of Natural Resources, we determined that the grantee had spent \$241,670 more than the \$2,480,387 it had reported on its final financial status report. According to the state's Office of Environmental Affairs accountant who prepared the financial information, Louisiana had not reported the \$241,670 in its final financial status report because

the grantee did not want to increase its required level of effort for fiscal year 1983.

In a similar case of underreporting in Region III, a grantee--the Maryland Department of Health and Mental Hygiene--used about one-half of the nonfederal expenditures of two of its local agencies to meet its required level of effort. Baltimore and Anne Arundel Counties received pass-through funds from the state's fiscal year 1982 air pollution control program grant. On their final financial status reports to the state, those counties reported a combined expenditure of \$592,785 in nonfederal funds. Maryland's expenditures for that year were insufficient to match its required level of effort; therefore, to maintain its grant eligibility, Maryland included in its final financial status report to EPA part of the two counties' nonfederal expenditures--specifically, \$256,497.63--just enough to meet, but not exceed, the state grantee's funding level for the preceding year. Maryland officials told us that they chose to report only part of the counties' nonfederal expenditures because full disclosure would have increased the state's required level of effort, which was not desired.

If the counties' spending cannot count towards the state grantee's level of effort, then Maryland did not meet its required nonfederal funding level for fiscal year 1982. On the other hand, if the use of the counties' expenditures is permissible, then Maryland did not fully disclose its nonfederal expenditures.

We have discussed both the Maryland case and that involving the state of Louisiana with EPA's Office of General Counsel. At the time of our discussion, EPA officials from that office had not made a legal determination on these cases. However, they said that they would work with the regional offices to address the legal issues involved in these cases.

In another case, one grantee in Region VI reported unliquidated obligations as expenditures, thereby overreporting its actual expenses. The Texas Air Control Board, in its final financial status report for fiscal year 1982, reported a total of \$14,475,552 in federal and nonfederal outlays. Our review showed that \$1.3 million of that amount was reported as unliquidated obligations, not actual expenditures. In the time since Texas filed that financial status report, it had liquidated almost all of those obligations, but in doing so, the grantee spent \$286,046 less in federal and nonfederal funds than it had obligated, of which \$31,390 constituted federal funds. Thus, the grantee over-reported total outlays by \$286,046, and received \$31,390 in fiscal year 1982 federal funds that should be returned to EPA.

EPA HAS NOT PERFORMED AUDITS TO
DETECT GRANTEE'S NONCOMPLIANCE

The instances described above in which grantees had not complied with fund usage and reporting regulations were unknown to

EPA headquarters and regional officials until we brought the problems to their attention. Those EPA officials stated that (1) too few resources are available in EPA to perform the detailed audits needed to detect such noncompliance and (2) examination of grantee records performed by state auditors and public accountants generally do not compare expenditures to financial status reports in enough detail to identify such discrepancies. Without the deterrence provided by an effective auditing program, EPA is unable to ensure that the grantees are correctly using or reporting grant funds.

Resources and priorities preclude
EPA's Inspector General from auditing
air pollution control program grants

Air pollution control program staff at the three EPA regional offices reviewed said that they would like to have grantee records audited by EPA's Office of the Inspector General, who has the responsibility to audit and investigate all EPA programs and operations. According to the program staff, such audits would help them ensure that section 105(b) expenditures are acceptable and are properly reported. Periodically, the program staff have submitted requests to the regional Inspector Generals to have audits performed. In Region III, for example, the staff submitted 14 requests for audit to the regional Inspector General between June 1981 and June 1982. Those requests represented about one-third of the total grants during that period. In 3 of the 14 requests, the program staff asked the Inspector General to give the audits priority attention because the grantees' air pollution control programs had terminated, and the program staff wanted to protect EPA's interests.

None of the 14 audit requests from Region III resulted in an Inspector General audit. Moreover, in the three regions we reviewed, the Inspector General had audited only 1 of the 235 grants awarded from fiscal year 1979 through 1982.

The regional Inspector General officials we contacted said that their audits are concentrated on areas of greater priority than the section 105 program because this program's funding is not large enough to warrant using their limited audit resources. In addition, officials from the Inspector General's Southern Division (one of five within the Office of the Inspector General) explained that past air program audits had yielded few findings--and that, when they did, EPA regions had seldom taken the steps to obtain the refunds due. An Inspector General official from EPA headquarters agreed with those statements and said that limited resources have, for the most part, prevented the Inspector General from performing section 105 audits. However, the headquarter's official believed that auditing a sample of section 105 grants could be a deterrent to misuse or inaccurate reporting of grant funds.

When the Region III audit requests were made, the regional Inspector General recommended that EPA's air pollution control

program officials employ other auditing means, such as desk reviews, to fill the resource gap. Desk reviews would not identify many of the financial reporting problems we found because grantees' expenditure documents are not available for verifications during those type of reviews. Instead, desk audits are used to evaluate program performance, looking at such things as the grantees' inspecting and permitting activities. Further, the program officials said that they lack the resources as well as the expertise necessary to verify the accuracy of grantees' expenditures against financial status reports.

Audits performed by other than EPA's
Inspector General do not always verify the
accuracy and reliability of financial reports

Without the Inspector General audits, EPA's program officials rely on outside audits of the grantees' financial status reports. These audits, performed by state auditors and public accounting firms, are known as "Attachment-P" audits because they derive their authorization from the Office of Management and Budget Circular A-102, Attachment P. That document provides for independent audits of the financial operations of federal grant recipients, including their compliance with relevant federal laws and regulations.

Attachment P requires that audits be made on an organization-wide basis rather than on a grant-by-grant basis. Such audits should determine whether

- financial operations are conducted properly,
- financial statements are presented fairly,
- the organization has complied with laws and regulations affecting the expenditure of federal funds,
- internal procedures have been established to meet the objectives of federally assisted programs, and
- financial reports to the federal government contain accurate and reliable information.

Because an Attachment-P audit is usually made on all funds connected with the grantee rather than individually on each grant, it does not equate to a specific grant audit, and the coverage it provides any one grant is less than that of a detailed grant-by-grant audit. The objectives of an Attachment-P audit are to determine whether

- revenues, expenditures, assets, and liabilities are effectively controlled and properly accounted for;
- financial statements are presented fairly in accordance with generally accepted accounting principles;

--federal financial reports contain accurate and reliable financial data and are presented in accordance with the terms of applicable agreements and Circular A-102; and

--federal funds are being expended in accordance with the terms of applicable agreements and those provisions of federal law or regulations that could have a material effect on the financial statements or on the awards tested.

Since an Attachment-P audit will test a representative sample of charges to federal awards held by the grantee, the air pollution control program expenditures might not be audited. However, if additional information is necessary concerning the air pollution control program, any additional audit work should build upon work already done under Attachment P.

We examined the 12 Attachment-P audits that had been performed on the 235 grant awards included in our review. We found that 1 of the 12 audits verified the grantees' air pollution control program financial records against the final financial status reports submitted to EPA. The other 11 Attachment-P audits did not provide EPA with enough information to verify whether the grantees' air pollution control program expenditures, as reported, were correct.

An official in Region IV's Financial Management Office said that an Attachment-P audit may not always review the accuracy and reliability of a grantee's final financial status report, and the time frames for the audits are state fiscal years, which often differ from those of the federal fiscal years. Other regional officials made similar observations. Therefore, in our opinion, there is a need for EPA's Inspector General to audit air pollution control grants to build upon the work done under Attachment-P audits.

CONCLUSIONS

In our verification of six grantees' expenditures for fiscal year 1982, we found that grantees in Maryland and Louisiana had not fully reported their nonfederal expenditures to EPA. Maryland reported \$256,497.63 of the \$592,785 spent by its county agencies to meet, but not exceed, its funding level of the preceding year. Louisiana reported \$241,670 less on its final financial report than it had actually spent because it did not want to increase its required level of effort. Because of the legal concerns in these two cases, EPA's Office of General Counsel needs to help the regional offices resolve these underreporting problems.

In another case, a grantee in the District of Columbia erroneously reported about \$8,200 in fiscal year 1982 grant expenditures which should be reimbursed to EPA. Also, a grantee in Texas reported \$1.3 million in unliquidated obligations which EPA treated as actual expenditures. When the actual expenditures became known, the grantee had spent \$286,046 less than it had

reported to EPA as obligated. Of that amount, \$31,390 constituted federal funds already received by the grantee from EPA. Those funds should be returned to EPA and the grantee's actual level-of-effort amount should be revised accordingly.

In our opinion, the high incidence of error showed in our review of the six grantees merits more audit attention than the Inspector General has given the section 105 grant program in the past. EPA regional staff have periodically requested the Inspector General to audit specific grantees, and on occasion have noted grantees that should be a priority for audit because those grantees were terminating their programs. Of 14 audit requests we reviewed in one region, none were subsequently audited by the Inspector General. Further, of the 235 grant awards we reviewed in the three regions from fiscal year 1979 through 1982, 1 Inspector General audit was performed.

The Inspector General is responsible for auditing all EPA programs, and without financial audits of air pollution control program expenditures, the EPA regions cannot determine whether grantees are correctly using or reporting federal and nonfederal funds under the section 105 grant program. An Inspector General official at EPA headquarters believes, and we agree, that auditing a sample of grants could be a deterrent to erroneous reporting of funds. Yet, all of the regional Inspector General officials we contacted said their audit resources are limited and are concentrated on projects of higher priority than the section 105 grant program. Further, EPA's air pollution control program officials said that they cannot fill in the audit resource gap because they lack the resources, as well as the expertise, to verify grantees' expenditures.

RECOMMENDATIONS

To ensure that section 105 grant funds are properly spent and/or reported, we recommend that the EPA Administrator direct the regional administrators in Regions III and VI to work with

--the Office of General Counsel to resolve the under-reporting of expenditures in Maryland and Louisiana and

--the District of Columbia and Texas, respectively, to resolve inappropriate spending or erroneous reporting of grant funds in fiscal year 1982.

Also, because (1) the Office of the Inspector General is responsible for auditing and investigating all EPA programs and operations and (2) the regional air pollution control program staff have neither the resources nor the expertise to verify grantees' expenditures, we recommend that EPA's Inspector General reconsider the priority assigned to the section 105 grant program, based on our review findings, and, if appropriate, conduct audits of specific grants to determine whether grantees' financial reports to EPA contain accurate and reliable information.



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